Supreme Court, U.S.
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No.

In the Supreme Court of the United States

ALABAMA MUNICIPAL INSURANCE CORPORATION, ET AL.,

Petitioners,

v.

STATE OF ALABAMA, ET AL.,

Respondents.

On Petition for a Writ of Certiorari to the Supreme Court of Alabama

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Whether the Supreme Court of Alabama erred when it rejected an equal protection challenge to two tax classifications that: (a) reward *past* conduct despite their asserted purpose of inducing *future* economic activity; (b) cannot plausibly be said to have been designed to advance their stated goals because those goals are inconsistent with state law and policy; and (c) are motivated solely by a desire to create a favored class.

2. Whether the plaintiff in a "rational basis" equal protection challenge must prove its case "beyond a reasonable doubt."

PARTIES TO THE PROCEEDING AND RULE 29.6 STATEMENT

In addition to the parties listed in the caption, American Colonial Insurance Co., Inc., Baldwin Mutual Insurance Co., Centennial Casualty Co., Liberty Southern Insurance Co., Inc., Safeway Insurance Co. of Alabama, and Southern Guaranty Insurance Co. are petitioners. H.E. Monroe, Jr., Commissioner of Revenue of the State of Alabama, and Michael DeBellis, Commissioner of Insurance of the State of Alabama, were parties to the proceedings in the Supreme Court of Alabama.

Petitioners submit the following corporate disclosure statement:

Alabama Municipal Insurance Corporation, Baldwin Mutual Insurance Co., and Liberty Southern Insurance Co., Inc. have no parent companies. American Colonial Insurance Co., Inc.'s parent company is The Colonial Company. Centennial Casualty Co.'s parent company is Robinson Adams Insurance Inc. Safeway Insurance Co. of Alabama's parent company is Safeway Insurance Co. Southern Guaranty Insurance Co.'s parent company is Winterthur U.S. Holdings, Inc. There are no publicly held companies (other than the listed parent companies) which own 10 percent or more of the stock of any of the petitioners.

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PETITION FOR A WRIT OF CERTIORARI

Alabama Municipal Insurance Corporation, American Colonial Insurance Co., Inc., Baldwin Mutual Insurance Co., Centennial Casualty Co., Liberty Southern Insurance Co., Inc., Safeway Insurance Co. of Alabama, and Southern Guaranty Insurance Co. petition for a writ of certiorari to review the judgment of the Supreme Court of Alabama in this case.

OPINIONS BELOW

The opinion of the Supreme Court of Alabama (App., *infra*, 1a-14a) is reported at 730 So. 2d 107. The judgment of the Circuit Court of Montgomery County (App., *infra*, 15a-26a) is unreported.

JURISDICTION

The judgment of the Supreme Court of Alabama was entered on May 22, 1998. A timely petition for rehearing was denied on February 19, 1999. App., *infra*, 27a. On May 11, 1999, Justice Kennedy extended the time for filing a petition for a writ of certiorari to and including June 18, 1999. The jurisdiction of this Court is invoked under 28 U.S.C. § 1257.

CONSTITUTIONAL PROVISION INVOLVED

The Fourteenth Amendment to the U.S. Constitution provides in relevant part: "No State shall * * * deny to any person within its jurisdiction the equal protection of the laws."

STATEMENT

This case, which involves a challenge to a wholly irrational scheme of state tax credits, presents fundamental questions about the scope of rational basis scrutiny under the Equal Protection Clause of the Fourteenth Amendment. We recognize, of course, that equal protection review of state tax legislation is highly deferential, and it is a truism that state economic classifications will be upheld so long as their

connection to the State's purposes "is not so attenuated as to render the distinction arbitrary or irrational." *Nordlinger* v. *Hahn*, 505 U.S. 1, 11 (1992). But the approach taken below effectively disavows *any* scrutiny of such legislation challenged under the Equal Protection Clause; the Alabama Supreme Court contented itself with a recital of the State's asserted purposes and made no attempt to inquire how those purposes possibly could be advanced by the State's scheme. Such an approach cannot be reconciled with this Court's repeated admonition that the "rational-basis standard 'is not a toothless one'" (*Schweiker* v. *Wilson*, 450 U.S. 221, 234 (1981) (quoting *Mathews* v. *Lucas*, 427 U.S. 495, 510 (1976))), conflicts with the holdings of other state supreme courts in closely analogous circumstances, and validates a distinction that manifestly does not further the State's articulated goals. Further review therefore is warranted.

A. Alabama's Insurance Premium Tax

The Alabama tax law at issue in this case is the direct successor to the discriminatory statute invalidated by this Court's decision in *Metropolitan Life Ins. Co.* v. *Ward*, 470 U.S. 869 (1985). The Court held the original statute unconstitutional because it imposed a higher insurance premium tax upon foreign insurance companies than upon domestic ones. In an attempt to remedy the deficiency identified by *Ward*, Alabama entered into negotiations with the *Ward* plaintiffs that eventually resulted in a proposal to set the base insurance premium tax for non-life and non-health insurance at 3.6% for both foreign and domestic insurers. This formula was modified, however, to accommodate Alfa Mutual Insurance Company ("Alfa"), Alabama's largest domestic property and casualty insurer.

In an attempt to gain Alfa's support, an attorney for the *Ward* plaintiffs transmitted to Alfa's attorney a proposal that included a draft of two tax credit formulas. Plaintiffs' Trial Exhibit ("Pl. Tr. Exh.") 33. The first formula (for the

"Office Facilities Credit") was designed to provide incremental credits based on both the number of insurance offices owned or leased by the insurer and the number of employees working in those offices, for a total credit not to exceed 1% of the insurer's taxable premiums.[1] The second formula (for the "Real Property Investment Credit") provided credits based on every $1 million in Alabama real estate owned by an insurer, also for an aggregate credit not to exceed 1% of taxable premiums. It is undisputed that, at the time the attorney for the *Ward* plaintiffs was developing these proposed credits, he was receiving detailed information from Alfa as to the number of offices and employees Alfa had in Alabama (Pl. Tr. Exh. 30) and the extent of its domestic real estate holdings. Pl. Tr. Exh. 28; R. 164-66, 193-94.

By early 1993, the 3.6% base premium tax and the two credits drafted for Alfa had made their way into a bill being considered by the Alabama legislature. Pl. Tr. Exh. 35. Before the bill ultimately was passed, however, Alfa requested one further change. Alfa asked that the multiplier used in the Real Property Investment Credit be adjusted so as to require a $10 million rather than a $3 million investment to receive the full 1% credit. Pl Tr. Exh. 40 (suggesting that insurers receive a 0.1% credit for each $1 million investment

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[1] The provision offers a specified credit against the premium tax for each office operated in the State, with the precise amount of the reduction determined by the number of employees in the office. An office with between one and three employees entitles the company to an 0.0025% credit; one with between four and ten employees provides a 0.0050% credit; one with between 11 and 50 employees offers a 0.0075% credit; and one with 51 or more employees provides a 0.01% credit. As noted in the text, the aggregate credit may not exceed 1% of the insurer's taxable premiums. See App., *infra*, 3a-4a n.1. The Office Facilities Credit contains no requirement that offices be placed in any particular type of location or meet any specific definition.

rather than a 0.35% credit). This change, which restricted the number of insurance companies that can take the full Real Property Investment Credit but had *no* effect on Alfa's ability to take the full credit, was adopted by the Alabama legislature.[2] As revised, the insurance premium tax credits were passed into law on May 17, 1993, and are codified at ALA. CODE § 27-4A-3(a)(3). App, *infra*, 28a.

Unsurprisingly, Alfa was the only company in Alabama that qualified to take both the full 1% Office Facilities Credit and the full 1% Real Property Investment Credit; the two credits allowed Alfa to reduce its 1995 tax liability from $10,728,560 to $5,960,311. App., *infra*, 17a. Two additional companies received partial credits.[3] But as the trial court found, none of the more than 600 other insurance companies doing property and casualty business in Alabama "realized a substantial benefit from the credits." *Id.* at 18a. See R. 31-32, Pl. Tr. Exh. 70.[4] In part, this is so because many companies are *precluded by Alabama law* from taking advantage of the Real Property Investment Credit. Section

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[2] As enacted, the Real Property Investment Credit entitles an insurer to a credit of 0.1% of its taxable premiums for each "$1,000,000 in value of real property investments in the State of Alabama." ALA. CODE § 27-4A-3(a)(3)d.2. The total credit may not exceed 1% of the insurer's taxable premiums, meaning that an investment of $10 million is needed to obtain the full available credit.

[3] Allstate Insurance Company and the State Farm Group respectively qualified for combined Office Facilities and Real Property Investment Credits of 1.17% and 1.215%. App., *infra*, 17a.

[4] Of the original eight plaintiffs, "two realized no credit. The credit realized by five plaintiffs ranges from .0025% to .02%. Southern Guaranty Insurance Company realized .3125% credit." App., *infra*, 18a.

27-41-34(b)(2) of the Alabama Code provides that an insurance company's real estate investments "shall not exceed 10 percent of the insurer's admitted assets." As a consequence, companies with less than $10 million in assets, including three of the petitioners in this case, are completely foreclosed from investing the $1 million necessary to receive even a marginal credit, while "[a] company with less than one hundred million dollars in assets is effectively prohibited from investing as much as ten million dollars in real estate," and thus from obtaining the full 1% investment credit. App., *infra*, 18a. As the trial court found, the tax classification accordingly "favors larger companies and concurrently burdens smaller ones." *Ibid.*

B. Proceedings Below

Pointing to the discriminatory effects of the credits, eight Alabama insurance companies brought this action in state court,[5] contending that the state scheme violates the equal protection guarantees of the United States and Alabama Constitutions. The trial court agreed, holding the tax credits unconstitutional under the state constitution. App., *infra*, 15a-26a. The court began by declaring that it was "mindful of the broad area of discretion available to the Legislature in tax matters," recognizing that it could not "substitute its preference merely because it disagrees with the legislative scheme." *Id.* at 19a. The court went on to note that, although "[t]he Alabama Legislature provided no express purpose for the subject legislation," "[t]he State's conceivable purposes fall into two broad categories. The first involves economic development including the promotion of insurance offices, employment and the insurance industry generally. The second involves the promotion of the availability of

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[5] One of the original plaintiffs, American Mining Insurance Co., is no longer a party to this action.

insurance, the encouragement of its use and the promotion of a vigorous insurance market." *Ibid.*

The trial court held, however, that these purposes are not advanced by the credits. While the court noted the State's claim "that the legislation will result in considerable economic benefits such as construction and employment," it found that the credits could not encourage *new* investment because they can be satisfied "by pre-legislative activity" — and Alfa in fact "achieved both credits through real estate investment and an office staffing situation[] *that existed at the time of the passage of the Act.*" App., *infra*, 20a (emphasis added). See *ibid.* ("The Act contains no requirement that there be economic activity as a condition to achieving either credit."). The court therefore concluded that

> [t]he relationship between [Alabama's] economic goals and the classification is attenuated. * * * The evidence is conclusive that the legislation ultimately provides a subsidy for Alfa and to a lesser extent Allstate and State Farm and as such, does not encourage vigorous competition, but tends to encourage monopoly * * * . The classification also appears to be inconsistent with settled state law or policies concerning the sound solvency regulation of insurance companies, free competition and fundamental economic rights. As such, some asserted purposes could be considered pretextual.

Id. at 20a-21a. Having thus held the credits unconstitutional under the state constitution, the trial court found it unnecessary to determine whether they also are inconsistent with the United States Constitution. *Id.* at 22a.[6]

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[6] In holding the tax invalid under the state constitution, however, the court cited several of this Court's equal protection decisions, including *Nordlinger* and *Allegheny Pittsburgh Coal Co.* v. *County Comm'n*, 488 U.S. 336 (1989). See App., *infra*, 20a-

On appeal, the Alabama Supreme Court reversed the trial court's state constitutional ruling and went on to hold that "it is not clear beyond a reasonable doubt that the tax credits at issue violate * * * the Federal Constitution." App., *infra*, 8a. First addressing the state constitutional arguments, the court reasoned that

> [w]e are not unaware of the argument that some insurers are prevented from investing the maximum amount in Alabama real estate because their total assets are too low. However, we note that the conditions prevailing today are not necessarily constant. Those companies could grow and thus be able to invest more. We find persuasive the State's argument that the statute does not discriminate, in that it does not create classes of insurers to be treated differently from other classes.

App., *infra*, 9a.

Turning next to the federal issue, the Alabama Supreme Court explained that the constitutional challenge would be resolved by application of the rational basis test. App., *infra*, 10a. With this in mind, the court noted the State's contention that it had three related purposes in enacting the credits: the Office Credit ostensibly was intended "to encourage competition among insurers in rural areas of the state" and "to encourage the employment of Alabama citizens," while the Real Property Investment Credit was designed "to encourage all insurance companies, foreign and domestic, to invest in Alabama property." *Id.* at 11a. Against this background, the court held, without further analysis, that

> [t]he tax credits employed reasonable classifications designed to reach the legitimate legislatively determined goals of encouraging investment in the state and

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[6] (...continued)
21a.

> encouraging employers to employ Alabama citizens and to open offices in rural areas. Whether the challenged tax credits are rationally related to these goals is "at least debatable." It was reasonable for the members of the legislature to believe that these goals would be promoted by the adoption of the credits. Consequently, we conclude that the challenged credits do not violate the Equal Protection Clause of the Fourteenth Amendment to the Federal Constitution.

Id. at 11a-12a.

REASONS FOR GRANTING THE PETITION

As a general matter, rational basis review under the Equal Protection Clause is highly deferential and "requires only that the classification rationally further a legitimate state interest." *Nordlinger*, 505 U.S. at 10. Even so, however, and "even in the ordinary equal protection case calling for the most deferential of standards, [the Court] insist[s] on knowing the relation between the classification adopted and the object to be attained. The search for the link between classification and objective gives substance to the Equal Protection Clause[.]" *Romer* v. *Evans*, 517 U.S. 620, 632 (1996). The decision below disregarded that requirement: although the Alabama Supreme Court recited the asserted rationales for the state classification, the court found it unnecessary to make any meaningful inquiry into whether the state scheme did (or possibly could) advance the State's ostensible purposes. This approach renders the Equal Protection Clause wholly meaningless.

While recognizing that legislatures must have substantial leeway in drawing social and economic classifications, this Court's decisions have identified at least three circumstances in which such classifications fail the rational basis test. *First*, when the legislature seeks to provide incentives for *future* behavior, classifications that accord differential treatment on the basis of *past* actions will not be considered rational. See,

e.g., *Zobel* v. *Williams*, 457 U.S. 55, 62 (1982). *Second*, when the asserted state interest supporting a distinction is inconsistent with established state policy, the legitimacy of the State's claim that it is attempting to advance that interest will be cast into doubt. See, *e.g.*, *Allegheny Pittsburgh Coal Co.* v. *County Comm'n*, 488 U.S. 336, 344-45 (1989); *Nordlinger*, 505 at 10. And *third*, when it is clear that the actual purpose of a challenged distinction is nothing more than the creation of a favored class, core principles of equal protection demand that the classification be struck down. See, *e.g.*, *Romer*, 517 U.S. at 634-635; *City of Cleburne* v. *Cleburne Living Ctr.*, 473 U.S. 432, 446-448 (1985). Here, the court below ignored each of these principles — in the process departing from this Court's holdings and creating a conflict with the decisions of other state courts of last resort.

Moreover, by requiring that petitioners prove their equal protection claim *beyond a reasonable doubt*, the Alabama Supreme Court erected a barrier foreign to this Court's constitutional jurisprudence. Not only is this strict evidentiary burden irrelevant to the purely legal question of a statute's facial validity (as at least one federal court of appeals has recognized), its application to rational basis challenges threatens to make impossible the already difficult task of proving such claims. This danger has been realized in the instant case, where the court below upheld a discriminatory tax scheme that sidesteps this Court's decision in *Ward* and continues to provide special treatment to Alabama's largest domestic property and casualty insurer by making irrational classifications.

Review of the decision below would allow the Court to bring necessary clarity and coherence to the law governing rational basis scrutiny. The Court has not infrequently struck

down state classifications for failure of the rational basis test,[7] but its decisions doing so have something of a "know it when you see it" quality. Guidance from this Court could help rein in extravagant invocations of the Equal Protection Clause — and, at the same time, could guard against state discrimination, like that in this case, that "has so speculative and attenuated a connection to its goal as to amount to arbitrary action." *Logan* v. *Zimmerman Brush Co.*, 455 U.S. 422, 442 (1982) (opinion of Blackmun, J.).

I. THE ALABAMA SUPREME COURT'S DECISION CONFLICTS WITH RULINGS OF THIS AND OTHER COURTS ON THE SCOPE OF "RATIONAL BASIS" REVIEW UNDER THE FOURTEENTH AMENDMENT'S EQUAL PROTECTION CLAUSE.

"When a state distributes benefits unequally, the distinctions it makes are subject to scrutiny under the Equal Protection Clause of the Fourteenth Amendment." *Hooper* v. *Bernalillo County Assessor*, 472 U.S. 612, 618 (1985) (footnote omitted). The broad outlines of this sort of scrutiny are familiar.

> In general, the Equal Protection Clause is satisfied so long as there is a plausible policy reason for the classification, * * * the legislative facts on which the classification is apparently based rationally may have been considered to be true by the governmental decisionmaker, * * * and the relationship of the

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[7] *See, e.g.*, *Romer*; *Quinn* v. *Millsap*, 491 U.S. 95 (1989); *Allegheny Pittsburgh*; *City of Cleburne*; *Hooper* v. *Bernalillo County Assessor*, 472 U.S. 612 (1985); *Williams* v. *Vermont*, 472 U.S. 14 (1985); *Zobel*; *Logan*, 455 U.S. at 438-442 (opinion of Blackmun, J.); *id.* at 443 (Powell, J., concurring in the judgment); *Lindsey* v. *Normet*, 405 U.S 56, 74-77 (1972); *United States Dep't of Agric.* v. *Moreno*, 413 U.S. 528 (1973).

> classification to its goal is not so attenuated as to render the distinction arbitrary or irrational.

Nordlinger, 505 U.S. at 11. The Alabama Supreme Court evidently regarded this test as so much boilerplate. But *meaningful* rational basis scrutiny is essential to preclude "arbitrary distinction[s]" (*Williams* v. *Vermont*, 472 U.S. 14, 22 (1985)), to "ensure that classifications were not drawn for the purpose of disadvantaging the group burdened by the law" (*Romer*, 517 U.S. at 633), and to "provide[] guidance and discipline for the legislature, which is entitled to know what sort of laws it can pass." *Id.* at 632. This Court's application of these principles in specific contexts relevant to this case removes any doubt that the tax credits challenged by petitioners violate the fundamental constitutional guarantee of equal protection.

A. The Alabama Supreme Court's Decision Conflicts With This Court's Teaching That Classifications Rewarding Past Actions Are Not Rationally Related To A Legitimate State Interest In Inducing Future Behavior.

1. The Alabama Supreme Court concluded that the tax credits at issue in this case are reasonably related to several legitimate state interests: encouraging the employment of Alabama residents, encouraging the opening of insurance offices in rural areas, and encouraging investment in the State. App., *infra*, 11a. All of these interests concern the inducement of *future* action by insurance companies. As the trial court observed, however — without contradiction from the state supreme court — the "Act contains no requirement that there be economic activity as a condition to achieving either credit." *Id.* at 20a. Rather, the credits are available to insurance companies that have the requisite number of employees, offices, or real estate holdings, even if those criteria are met "by pre-legislative activity." *Ibid.* For example, Alfa, the largest domestic property and casualty

insurance company in Alabama and the principal beneficiary of the tax credits, qualified for the maximum credits based *entirely* on its past behavior; it accordingly has no incentive under the Act to make any future investments. Under these circumstances, the connection between the challenged classifications and the State's purported interest in spurring future investment is far too attenuated to pass constitutional scrutiny.

In a very similar case, this Court recognized that an asserted interest in inducing *future* action cannot be rationally furthered by a classification that selectively provides benefits for *past* conduct. In *Zobel*, the Court examined an Alaska dividend program enacted in 1980 that provided benefits to citizens from a state fund based on years of residency subsequent to 1959. Much like Alabama here, Alaska contended in *Zobel* that its benefit program created a "financial incentive for individuals to establish and maintain residence in Alaska." 457 U.S. at 61. The Court rejected this argument in no uncertain terms: "the State's interest is not in any way served by granting greater dividends to persons for their residency during the 21 years prior to the enactment." *Id.* at 62 (footnote omitted). The Court subsequently reaffirmed that principle in *Hooper*, holding that "the legislature cannot plausibly encourage [the desired conduct] by passing such retroactive legislation." 472 U.S. at 619 (footnote omitted). Likewise, Alabama's interest in inducing future investment is not in any way furthered by giving tax credits for real estate already purchased, offices already opened, and employees already hired.

In addition to holding that Alaska's dividend program did not further the State's asserted interest in encouraging immigration, the *Zobel* Court observed that providing benefits for past residency actually would undermine the State's asserted interest because newcomers would be at a relative disadvantage and "more likely to become dissatisfied and to leave the State." 457 U.S. at 62 n.9. The Court explained:

> [I]t would thus seem that the State would give a larger, rather than smaller, dividend to new residents if it wanted to discourage emigration. The separation of residents into classes hardly seems a likely way to persuade new Alaskans that the State welcomes them and wants them to stay.

Ibid. This reasoning applies with equal force here. Alabama's tax credits — which give a substantial tax (and competitive) advantage to large and established insurance companies that already have made the requisite investments — likely will discourage smaller companies from entering a market where they will be at an immediate (and, as we explain below, permanent) disadvantage. It thus seems undeniable that the separation of insurance companies into a favored class of fully invested companies and a disfavored class of small companies that have the potential for future growth is "not rationally related to the State's asserted legislative goal." *Hooper*, 472 U.S. at 622.

This fatal flaw — providing a reward for past behavior when the State's asserted interest is inducing future conduct — is not cured by the fact that the Alabama tax credits apply both to past and to future action. The same was true of the statute struck down in *Zobel*, which granted "increased dividend benefits for each year of continued Alaska residence." 457 U.S. at 62. Although the Court assumed that this aspect of the Alaska law "might give some residents an incentive to stay in the State in order to reap increased dividend benefits in the future" (*ibid.*), it concluded that it "need not consider whether the State could enact the dividend program prospectively only." *Id.* at 64. Instead, the Court invalidated that portion of the statute that provided benefits for pre-enactment conduct and remanded the case so that the Alaska Supreme Court could consider the severability of the statute. *Id.* at 64-65. The same should be done here.

2. The Alabama Supreme Court's rejection of the proposition that it is irrational to use rewards for past conduct as a means to induce future behavior — despite the trial court's recognition of the problem (see App., *infra*, 20a) and petitioners' focus on the issue (see Brief of Appellees in the Supreme Court of Alabama at 43-45) — stands in clear contrast to decisions of other state supreme courts that have applied *Zobel* to strike down discriminatory tax credits and fee reductions. For example, in *Bagley* v. *Vermont Dep't of Taxes*, 500 A.2d 223 (Vt. 1985), the Supreme Court of Vermont considered a tax credit that was made available to individuals who installed certain types of energy systems in their homes. To earn the credit for a particular year, Vermont taxpayers had to show not only that they had installed a qualifying system, but also that they were Vermont residents for the entire calender year. As a result, an individual who moved to Vermont from another State on July 1 of a given year and immediately installed a qualifying system would not be eligible for the tax credit, whereas an individual who resided in Vermont from January 1 through July 1 and then installed the same system would be eligible.

Relying on this Court's decision in *Zobel*, the Vermont Supreme Court held that using past behavior as a criterion for awarding benefits "bears no rational or legitimate relationship to a legislative purpose." The court explained:

> The durational residency requirement addresses a time prior to installation of the system. Obviously, requiring permanent residency *before* installation does not encourage installation of alternative energy systems and, if anything, discourages it. * * * The[r]e are valid reasons to require post-installation continuing residency, * * * but pre-installation permanent residency "is a wholly arbitrary basis on which to distinguish among present Vermont [residents]."

Id. at 226 (quoting *Williams*, 472 U.S. at 23) (citation omitted). Similarly, to the extent that the Alabama tax credits provide disparate benefits based on past conduct, they do not encourage future investment and are a wholly arbitrary basis on which to distinguish among insurance companies doing business in Alabama.

The Vermont Supreme Court is not alone in recognizing the applicability of the *Zobel* principle to cases in which state interests in inducing future conduct are asserted to support classifications that are based, at least in part, on past behavior. In *Gilman* v. *Martin*, 662 P.2d 120 (Alaska 1983), the Alaska Supreme Court reviewed a municipal ordinance that provided for a five percent reduction in the sale price of public land for each year that the private buyer had been a resident of the municipality. The State argued that the discount program could be upheld despite *Zobel* because it "rationally further[ed] a legitimate government purpose; namely, inducing residents to remain in their communities." *Id.* at 128. The Alaska Supreme Court flatly rejected this contention, explaining that, "[t]o the extent that discounts are granted for years of residence completed prior to the enactment of the ordinance, *it is not even a close question* that [the ordinance] is unconstitutional. *Id.* at 129 (emphasis added). In a similar manner, insofar as the Alabama tax credits are granted for investments made prior to the enactment of the insurance premium tax statute, it is beyond debate that they are unconstitutional.

B. The Alabama Supreme Court's Decision Cannot Be Reconciled With The Rule That Classifications Inconsistent With State Law Are Not Rationally Related To Legitimate State Interests.

The decision below upholding the Real Property Investment Credit departs from this Court's precedents for a related reason as well. Although assertedly designed to encourage investment by insurance companies in Alabama

real estate, Alabama law actually *precludes* most of the State's insurance companies from taking full (and in many cases, *any*) advantage of the credit. As we have noted, state law prohibits insurance companies from investing more than 10% of their assets in real estate, meaning that a company must own $10 million in assets to use the credit at all, and must have $100 million in assets to even theoretically be in a position to make full use of the credit. For this reason, the trial court, citing *Allegheny Pittsburgh* and *Nordlinger*, held that the credit is invalid because it is "inconsistent with settled state laws or policies." App., *infra*, 20a. But the Alabama Supreme Court rejected this consideration as irrelevant, opining blithely that "[t]he tax credits employed reasonable classifications designed to reach the legitimate legislatively determined goals of encouraging investment in the state." *Id.* at 11a. That approach, which assesses the challenged classification in a vacuum and ignores other elements of state law that belie the State's asserted justification for its scheme, cannot be reconciled with this Court's holdings.

Allegheny Pittsburgh involved a practice by a West Virginia county tax assessor of assessing recently acquired property at the purchase price while making "only minor modifications in the assessments of land which had not been recently sold. This practice resulted in gross disparities in the assessed value of generally comparable property." 488 U.S. at 338. Although the Court recognized that "a State may divide different kinds of property into classes and assign to each class a different tax burden so long as those divisions and burdens are reasonable," it concluded that "West Virginia ha[d] not drawn such a distinction. Its Constitution and laws provide that all property of the kind held by the petitioners shall be taxed at a rate uniform throughout the State according to its estimated market value." *Id.* at 345. Because the county tax assessor's practice was inconsistent

with this state-law principle of equal taxation,[8] the Court concluded that it was not rationally related to a legitimate state interest. *Ibid.*

The holding of *Allegheny* — that classifications whose asserted rationales are inconsistent with established state policy will be held irrational — was reaffirmed in *Nordlinger*, a case in which the Court upheld a tax assessment system in California that had virtually the same effect as the practice struck down in *Allegheny*. In considering the California system, the *Nordlinger* Court had "no difficulty in ascertaining at least two rational or reasonable considerations" that justified the system: local neighborhood preservation and protection of existing owners' reliance interests. 505 U.S. at 12. By contrast, the Court explained that there was no "indication in *Allegheny Pittsburgh* that the policies underlying an acquisition-value taxation scheme could conceivably have been the purpose for the * * * tax assessor's unequal assessment scheme" because "the West Virginia 'Constitution and laws provide that all property of the kind held by petitioners shall be taxed at a rate uniform throughout the State according to its estimated market value.'" *Id.* at 15 (quoting *Allegheny Pittsburgh*, 488 U.S. at 345). See *id.* at 26 (Thomas, J., concurring in part and concurring in the judgment) ("According to the Court, * * * the Webster County scheme * * * was irrational because it was contrary to state law."); see also *Williams*, 472 U.S. at 26 ("the exemption cannot be justified as an indirect means of encouraging out-of-staters to * * * pay Vermont sales tax, for the straightforward reason that Vermont does not impose its sales tax on nonresidents").

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[8] See also *Allegheny Pittsburgh*, 488 U.S. at 345 ("Indeed, her practice seems contrary to that of the guide published by the West Virginia Tax Commission as an aid to local assessors in the assessment of real property.").

The common-sense rule that a State's asserted goals must be rejected as implausible when they are irreconcilable with state law has been given force by other state supreme courts in the federal equal protection context. In *South Dakota* v. *American Bankers Ins. Co.*, 374 N.W.2d 609, 615 (S.D. 1985), the Supreme Court of South Dakota reviewed an insurance premium tax that charged higher rates to foreign companies that lacked licenses to do business in the State than it did to foreign companies that held such licenses. In defending the distinction, the State argued that it "promote[d] a more competitive insurance industry in South Dakota by encouraging foreign insurers to do insurance business" there. *Id.* at 617. The Supreme Court of South Dakota rejected this argument, however, pointing to a "manifest conflict between this stated purpose and [another South Dakota statute], which exempt[ed the plaintiff,] as a foreign insurer, from obtaining a certificate of authority in South Dakota." *Ibid.* Since the "discriminatory premium tax penalize[d] the very conduct seemingly promoted under [the other statute]," the court concluded that the "stated purposes for the imposition of a higher tax on unlicensed foreign insurers [we]re pretextual." *Ibid.*

Like *Allegheny Pittsburgh* and *American Bankers*, this is a case where the conflict between the challenged classifications and established state law "preclude[s] any plausible inference that the reason for the unequal" treatment is rationally related to a legitimate state interest. *Nordlinger*, 505 U.S. at 16. See generally *United States* v. *Carolene Prods. Co.*, 304 U.S. 144, 152 (1938) (legislation invalid if "in the light of the facts made known or generally assumed it is of such a character as to preclude the assumption that it rests upon some rational basis within the knowledge and experience of the legislators") (footnote omitted). According to the State, the Real Property Investment Credit is "designed to encourage all insurance companies * * * to invest in Alabama property." App., *infra*, 11a. But the State surely

understands, and the court below acknowledged (see *id.* at 9a), that many insurance companies are forbidden by Alabama law from making the type of investment that would enable them to qualify for the Real Property Investment Credit. In these circumstances, it is "impossible to credit" the State's justification for its classification. *Romer*, 517 U.S. at 635. That is fatal to the state scheme: "this Court's review does require that [the asserted] purpose may conceivably or 'may reasonably have been the purpose and policy' of the relevant governmental decisionmaker." *Nordlinger*, 505 U.S. at 15 (citation omitted).[9]

Moreover, Alabama's effort to *discourage* real estate investments by insurers is not limited to its maximum investment rule. Richard Ford, Chief Examiner for the Alabama Insurance Department, testified that with respect to solvency — an issue of particular concern given the numerous insurance company insolvencies that resulted from the collapse of real estate values in the 1980s — the State regards real estate as falling in the same category as junk bonds. R.

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[9] The Alabama Supreme Court's suggestion (in the context of its discussion of the state constitutional challenge) that companies now precluded from taking advantage of the real estate credit someday "could grow and thus be able to invest more" (App., *infra*, 9a) hardly saves the day for the State. Requiring small insurance companies to grow large before they can compete on a level playing field is inconsistent with Alabama's policy of promoting small businesses. See R. 313-18; Pl. Tr. Exh. 61 at 12-14. Moreover, an otherwise irrational classification that withholds a benefit from persons with low incomes surely would not be deemed constitutional because some of those persons one day might win the lottery. Cf. *Lindsey* v. *Normet*, 405 U.S. 56, 72-79 (1972). The undeniable fact is that most petitioners now (and for the foreseeable future) are unable to make full use of the credit, and as they "possessed no power [to make the requisite investments], it is unfair and irrational to punish them." *Logan*, 455 U.S. at 444 (Powell, J., concurring in the judgment).

381. Indeed, it is notable that, so far as we are aware, there is no other premium tax law in the United States that provides a credit similar to either of the credits available in Alabama. See R. 62. This "absence of precedent for [the credits] is itself instructive; '[d]iscriminations of an unusual character especially suggest careful consideration to determine whether they are obnoxious to the constitutional provision.'" *Romer*, 517 U.S. at 633 (citation omitted). Since securing solvency for the benefit of policyholders is the *sine qua non* of insurance regulation,[10] it seems inconceivable that a legitimate state interest could be served by blindly encouraging indiscriminate real estate investment by insurance companies. See generally *Heller* v. *Doe*, 509 U.S. 312, 321 (1993) ("the standard of rationality as we so often have defined it must find some footing in the realities of the subject addressed by the legislation").[11]

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[10] See ALA. CODE § 27-2-21 (establishing procedures to determine whether "every insurer licensed in this state" has the "ability to fulfill its obligations"). See generally INSURANCE, GOVERNMENT AND SOCIAL POLICY 64 (Spencer L. Kimball & Herbert S. Denenberg eds., 1969) ("The central objective of insurance regulation is to ensure the 'solidity' of every insurance company.").

[11] Not only is there a manifest conflict between the Real Property Investment Credit and Alabama law, there is a similar inconsistency between the Office Facilities Credit and Alabama policy. Dr. Claude Lilly, author of the National Association of Insurance Commissioners' RISK-BASED CAPITAL MANUAL, testified without contradiction that the artificial office configuration encouraged by the Office Facilities Credit is inconsistent with sound solvency regulation. R. 310; Pl. Tr. Exh. 113. Dr. Lilly's testimony is particularly noteworthy because Alabama has an avowed policy of meeting the "standards set by the National Association of Insurance Commissioners." ALABAMA ACTS 1993,

(continued...)

In addition to recognizing a tension between the State's asserted interest and its "law or policies concerning the sound solvency regulation of insurance companies," the trial court noted that the challenged credits also "tend[] to encourage monopoly inconsistent with Article IV, § 103" of the Alabama Constitution. App., *infra*, 20a-21a. The court explained that "[t]he evidence is conclusive that the legislation ultimately provides a subsidy for Alfa and to a lesser extent Allstate and State Farm and as such, does not encourage vigorous competition." *Id.* at 20a. The trial court also noted that the challenged tax scheme "favors larger companies and concurrently burdens smaller ones." App., *infra*, 18a.[12] This disadvantaging of small companies in the competitive marketplace directly conflicts with Alabama's longstanding policy of promoting small businesses. R. 313-18 (testimony of Insurance Commissioner Michael DeBellis); Pl. Tr. Exh. 61 at 12-14 (Alabama's brief to this Court in *Ward*).[13]

As noted above, the Supreme Court of Alabama did not reject, or even attempt to explain away, the trial court's seemingly self-evident conclusion that the challenged tax

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[11] (...continued)
No. 93-675, § 1, reprinted at ALA. CODE § 27-2-21, Code Commissioner's Notes.

[12] The State's own expert, Dr. Harold Skipper, agreed with this assessment at trial. R. 571-72.

[13] On a related note, Alabama's claim that the credits are intended to promote insurance in rural areas cannot be reconciled with its claim in *Ward* that the best way to promote rural insurance is to provide economic incentives to small insurance companies. Pl. Tr. Exh. 1, ¶ 10 (Alabama's list of legitimate state purposes for the statute challenged in *Ward*). The fact that the tax credits disadvantage small insurance companies, and contain no requirement that large companies open rural offices, belies any claim that the credits are intended to promote rural insurance.

credits are inconsistent with state law and policy. Because this Court's decisions make clear that such inconsistencies "preclude[] any plausible inference that the reason for the unequal" treatment is rationally related to a legitimate state interest (*Nordlinger*, 505 U.S. at 16), the decision of the Alabama Supreme Court cannot stand.

C. The Alabama Supreme Court's Decision Conflicts With The Rule That Classifications Undertaken For Their Own Sake Deny Equal Protection.

In cases such as this, where the asserted state interests are "so far removed" from the classifications at issue that it is "impossible to credit them" (*Romer*, 517 U.S. at 635), there is a strong likelihood that the classifications have been "undertaken for [their] own sake, something the Equal Protection Clause does not permit." *Ibid.* That danger has been realized here, where it cannot seriously be doubted that the true purpose of Alabama's tax credits was to create a favored class of politically influential insurance companies who would benefit from the tax credits at the expense of hundreds of smaller and less powerful competitors.

The history of the Insurance Premium Tax makes clear that Alfa was the driving force behind the adoption of the tax credits. The whole concept of Office Facility and Real Property Investment Credits was developed for Alfa's benefit (R. 144, 150-51, 158-60, 163-66, 194; Pl. Tr. Exh. 28, 30, 33), and the criteria for the credits were carefully crafted to ensure that Alfa (and Alfa alone) received the maximum allowable benefit. Indeed, although the bill reported out of committee in the Alabama legislature would have allowed a broader range of companies to share in the benefits from the Real Property Investment Credit, Alfa suggested that the credit be dramatically limited (see page 3, *supra*), and the Alabama legislature dutifully made the change. As a result, not only has Alfa enjoyed a full credit from the very start, but it has also enjoyed a considerably greater advantage over its

competition than it would have if the tax credit had been made more widely available.

In saying this, we do not mean to suggest that legislative attempts to benefit particular industry groups, or even particular constituents, necessarily run afoul of equal protection principles. But the gerrymandering of the credits plainly belies the neutral and high-minded rationales asserted by the State as the bases for its tax scheme here. And the State's attempt to accomplish its purpose by advantaging some and disadvantaging other taxpayers — all of whom are, for all relevant purposes, identically situated — is insupportable. After all, "it is not enough, under the Equal Protection Clause, to say that the legislature sought to [benefit particular persons] and succeeded in doing so, for that is 'a mere tautological recognition of the fact that [the legislature] did what it intended to do." *Logan*, 455 U.S. at 441 (opinion of Blackmun, J.) (citation omitted). Instead, "[t]he Court still has an obligation to view the classificatory system, in an effort to determine whether the disparate treatment accorded the affected classes is arbitrary." *Ibid*. Here, that examination reveals that the State is pursuing a course of action driven by its desire to affect only "some fraction of the body politic." *City of Cleburne*, 473 U.S. at 448. And as Justice Stevens has explained:

> A legitimate state interest must encompass the interests of members of the disadvantaged class and the community at large, as well as the direct interests of the members of the favored class. It must have a purpose or goal independent of the direct effect of the legislation and one "that we may reasonably presume to have motivated an impartial legislature." * * * If the goal of discriminatory classification is not independent from the policy itself, "each choice [of classification] will import its own goal, and each goal will count as acceptable, and the requirement of a 'rational' choice-goal relation will be satisfied by the very making of the choice."

Nordlinger, 505 U.S. at 34 (Stevens, J., dissenting) (quoting Ely, *Legislative and Administrative Motivation in Constitutional Law*, 79 YALE L.J. 1205, 1247 (1970)). See also *Ward*, 470 U.S. at 882 n.10 (rejecting the view that "any discrimination subject to the rational relation level of scrutiny c[an] be justified simply on the ground that it favor[s] one group at the expense of another"); *Romer*, 517 U.S. at 634; *City of Cleburne*, 473 U.S. at 446-47.

II. THE ALABAMA SUPREME COURT ERRED IN REQUIRING PETITIONERS TO PROVE THEIR EQUAL PROTECTION CLAIM "BEYOND A REASONABLE DOUBT."

The Alabama Supreme Court's error is perhaps explained as the product of a fundamental misunderstanding of the nature of the plaintiff's burden in an equal protection case. The court premised its decision on the threshold determination that the State's tax scheme had to be upheld because "it is not clear *beyond a reasonable doubt* that the tax credits at issue violate * * * the Federal Constitution." App., *infra*, 8a-9a (emphasis added). A number of other state courts of last resort also have held that federal rational basis claims must be proved beyond a reasonable doubt. *See Westling* v. *County of Millie Lacs*, 581 N.W.2d 815, 818-20, 822 (Minn. 1998), *cert. denied*, 119 S. Ct. 872 (1999); *Pace Membership Warehouse* v. *Axelson*, 938 P.2d 504, 506 (Colo. 1997); *Wisconsin* v. *Akins*, 544 N.W.2d 392, 395-96 (Wisc. 1996); *Richardson* v. *Sport Shinko*, 880 P.2d 169, 191 (Haw. 1994); *Bruns* v. *Iowa*, 503 N.W.2d 607, 610 (Iowa 1993); *Blaske* v. *Smith & Entzeroth, Inc.*, 821 S.W.2d 822, 829 (Mo. 1991); *Ford Motor Co.* v. *Barrett*, 800 P.2d 367, 374 (Wash. 1990); *Harbor Ins. Co.* v. *Groppo*, 544 A.2d 1221, 1224 (Conn. 1988); *Birchfield* v. *Birchfield*, 417 N.W.2d 891, 894 (S.D. 1988). In contrast, this Court has never applied the "beyond a reasonable doubt" burden of proof in its many equal protection cases using the rational basis test, and so far as we have been able to determine no federal court

of appeals has done so either. The state court's application of such a standard here demonstrated confusion about the nature of the relevant inquiry and imposed an essentially insuperable burden on victims of discriminatory enactments.

In fact, the questions to be answered by the court in a case like this one — whether the State's justifications are legitimate, and whether a legislator rationally could have thought those justifications to be advanced by the state classification — are *legal* ones to which the standard of proof simply has no application at all. See *Oklahoma Educ. Ass'n* v. *Alcoholic Beverage Laws Enforcement Comm'n*, 889 F.2d 929, 932-33 (10th Cir. 1989) (whether a statute's classifications "are rationally related to legitimate state interests" for equal protection purposes "is a question of law").[14] As a consequence, it appears that the only federal court of appeals to confront the argument that the "beyond a reasonable doubt" standard should apply to federal constitutional challenges rejected it out of hand. *Branson Sch. Dist. RE-82* v. *Romer*, 161 F.3d 619, 636 n.15 (10th Cir. 1998), *cert. denied*, 119 S. Ct. 1461 (1999) ("This circuit has never applied such a standard of proof to a purely legal question of whether a statute is facially unconstitutional."). See generally *FCC* v. *Beach Communications, Inc.*, 508 U.S. 307, 315 (1993) ("a legislative choice is not subject to courtroom fact finding"); *Cooper* v. *Mitchell Brothers' Santa Ana Theater*, 454 U.S. 90, 92-93 (1981) (the "purpose of a standard of proof is to instruct the *factfinder* concerning the degree of confidence our society thinks he should have in the correctness of his *factual* conclusions") (citation omitted) (emphasis added).

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[14] See also *United States* v. *Baker*, 63 F.3d 1478, 1490 (9th Cir. 1995) ("Equal protection claims are questions of law which we review de novo."); *United States* v. *Johns*, 984 F.2d 1162, 1163 (11th Cir. 1993) (whether a Sentencing Guidelines provision violates "equal protection rights is a question of law").

In any event, to the extent that the inquiry here is thought to have a factual component, the "beyond a reasonable doubt standard" plainly is the wrong one to apply. The Court has explained that this standard "historically has been reserved for criminal cases." *Addington* v. *Texas*, 441 U.S. 418, 428 (1979). *See Cooper*, 454 U.S. at 93 ("the Court has never required the 'beyond a reasonable doubt' standard to be applied in a civil case"). Even in civil cases where "particularly important interests" are at stake, the Court has applied the "clear and convincing" rather than the "beyond a reasonable doubt" standard. See *ibid.* (observing that the "clear and convincing" standard has been used in cases involving civil commitment, deportation, denaturalization, and free speech); *id.* at 93-94 (holding that First and Fourteenth Amendments do not require use of the "beyond a reasonable doubt" standard in obscenity cases). Thus, even assuming that there is a factual component to the rational basis equal protection inquiry that calls for application of a burden of proof, this Court's decisions make clear that the "beyond a reasonable doubt" standard is wholly inapposite.

At bottom, the Alabama Supreme Court appears to have confused the rigorous *substantive* standard imposed on rational basis plaintiffs (requiring proof that the state classification is arbitrary) with the *evidentiary* standard (if any) used to assess those claims. In doing so, the court imposed a burden on equal protection plaintiffs that is unique in civil litigation. And by superimposing the strictest burden of proof on top of the already difficult substantive burden borne by those plaintiffs, the court rendered rational basis scrutiny an empty exercise. Because the approach taken below cannot be squared with this Court's holdings — and because it involves an error that has infected review of

federal constitutional claims in many other States — further review is warranted.[15]

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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[15] We note that, before its discussion of the rational basis test, the Alabama Supreme Court stated that the tax credits do "not discriminate" because all "taxpayers who meet the clear and objective criteria have been treated equally." App., *infra*, 9a. This portion of the court's opinion appears to relate only to the question of the tax credits' validity under state law. But to the extent that this conclusion was intended to apply to the petitioners' federal claim, it is in direct conflict with this Court's decision in *Williams*, 472 U.S. at 27 ("[T]he fact that all those not benefited by the challenged exemption are treated equally has no bearing on the legitimacy of that classification in the first place. A State cannot deflect an equal protection challenge by observing that in light of the statutory classification all those within the burdened class are similarly situated.").